INTERPRETING AND DRAFTING RETAINED ACREAGE PROVISIONS – PARTIAL TERMINATION OF LEASEHOLD RIGHTS

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CHAPTER 3

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INTERPRETING AND DRAFTING RETAINED ACREAGE PROVISIONS - PARTIAL TERMINATION OF LEASEHOLD RIGHTS

I. INTRODUCTION

The rapid evolution in finding and developing unconventional reservoirs, primarily shales, and their development through horizontal drilling and use of related new technologies for drilling, completing and producing wells has collided with the lagging evolution of oil and gas leases and lease provisions causing problems for explorationists and oil and gas law practitioners.¹ Oil and gas law practitioners understand that, when interpreting or drafting an oil and gas lease, assignment, or farmout for a client, the practitioner must ensure all of the provisions in the instrument work together. If the provisions fail to work together, the lease or other instrument may unexpectedly terminate, in whole or in part, and litigation may follow. The oil and gas law practitioner's goal of harmonizing the separate provisions in the lease or other instrument has become increasingly challenging when interpreting or drafting retained acreage, continuous development, pooling, and other related provisions in the creation of the leases or other instruments, and in drafting amendments to previouslycreated leases and other instruments in force and effect held by production from times predating the development of unconventional plays.

Retained acreage provisions are most commonly found in oil and gas leases. However, they are sometimes incorporated in farmout agreements and their associated assignments, term assignments of leases, as well as other oil and gas transactional instruments. Retained acreage provisions typically will terminate the lease/contract insofar as undeveloped acreage, being acreage located outside the acreage attributed or assigned to a producing well.² The acreage associated with the producing well, herein developed acreage, will remain subject to the lease/contract. Increased usage of retained acreage provisions and the diversity of triggering events and retained developed acreage terms within them have resulted in confusion of their application between parties on occasion.³

Retained acreage provisions, like Pugh clauses and Freestone riders, were intended to promote development of all lands covered by oil and gas leases. They require the lessee to either release undeveloped acreage at some point during the term of the lease or provide for the undeveloped acreage to automatically terminate. Although it is suggested that retained acreage provisions were originally drafted to prevent the lessee from losing the developed acreage portions of a lease, the provisions more technically identify and/or designate the productive acreage attributed to the lessee's wells thereby inversely identifying and/or designating what acreage remains undeveloped and will terminate. In general, retained acreage provisions can include, or are directly impacted by, Pugh clauses, Freestone riders, automatic partial termination by (i) surface area ("Vertical Pugh") or by (ii) depths/geologic formations ("Horizontal Pugh"), and continuous development provisions. It is key for Attorneys and Landmen to assess what acreage and/or depths/geologic formations terminate automatically or are required to be released by lessee upon the triggering of the retained acreage provisions.

II. RETAINED ACREAGE PROVISIONS DISTINGUISHED FROM RELATED PROVISIONS

Retained acreage provisions originated to prevent a lessee from holding undeveloped acreage described in a lease/contract by means of single lease well or a few lease wells by providing a mechanism for the undeveloped acreage to terminate. Prior to their advent, all the acreage covered by an oil and gas lease could be held by a single lease well.

¹ See Stephen Jay Gould, The Structure OF

EVOLUTIONARY THEORY 766 (Harvard Univ. Press 2002) (discussing the theory of punctuated equilibrium). The geologic or paleontologic theory of punctuated equilibrium was offered to explain macroevolution of species and speciation expressed in geological time. The proposition, punctuated equilibrium, holds that the majority of species originate in geological moments called punctuations, then persist in stasis for long durations. This theory embodies three concepts: stasis (status quo), punctuation (instantaneous or very rapid and dynamic stress and changes to the status quo), and dominant relative frequency (settlingin period following a punctuation arriving at a new stasis or status quo). In this paper, the oil and gas industry equilibrium was punctuated by rapid and far-reaching technological changes brought about by horizontal drilling and obtaining economic oil and gas production from shales and other unconventional reservoirs.

² Retained acreage provisions, unlike Pugh clauses, do not require pooling in order to become effective.

³ Although retained acreage provisions were initially created to preclude the lessee from losing portions of a lease, which contained productive wells, the term has been expanded to include provisions requiring the release of all acreage which is not within a spacing, proration, or drilling unit, at the end of the primary term. Bruce M. Kramer, *Oil and Gas Leases and Pooling: A Look Back and a Peek Ahead*, 45 TEX. TECH. L. REV. 877, 881 n.28 (2013).

RETAINED ACREAGE PROVISIONS

- i. may be included in oil and gas leases, farmouts, term assignments, etc., where the acreage which is the subject of the lease, farmout, term assignment, etc., exceeds the acreage which can be attributed to a single well as productive acreage; and
- ii. usually trigger at an event or alternative events certain, which are defined in the instrument; and
- iii. the acreage being retained and/or depths/geologic formations may be assessed or quantified by information contained only in the lease/contract; or
- iv. the acreage and/or depths/geologic formations being retained may be assessed or quantified by information outside of the lease/contract for construction (such as facts related to development, or such as Railroad Commission of Texas rules and regulations); and
- v. are not triggered by lessee's exercise of pooling authority; and
- vi. are usually not recurring events in a lease (although it can be the same recurring event applied to different lands in a farmout agreement, etc.).

Pugh clauses and Freestone riders are distinguished from retained acreage provisions in that Pugh clauses and Freestone riders trigger only when lessee has exercised the pooling authority granted in a lease.⁴

A Horizontal Pugh clause is the name ascribed to provisions which, after being triggered by lessee's exercise of pooling authority, cause undeveloped depths or stratigraphic intervals covered by leases/contracts to automatically terminate or are required to be released. This term is regularly being applied to all types of Depth Severance provisions (if termination is on a depth-dependent basis) or Stratigraphic Severance provisions (if termination is on a geological/stratigraphic basis) whether triggered by lessee's exercise of pooling authority or not. A Pugh clause aka Vertical Pugh clause provides for termination of undeveloped acreage not included within the lateral boundaries of a pooled unit.

Continuous Development provisions often work in connection with retained acreage provisions and pooling provisions, usually providing lessees reasonable time-frames to further develop their lease premises after the expiration of the lease's/contract's primary term.

Separate Lease provisions govern designated producing blocks of acreage established by operation of retained acreage provisions and Pugh clauses. Under Separate Lease provisions, the distinct producing blocks are deemed to be separate, independent leases, each governed by the terms and provisions of the original lease. Separate Lease provisions create new lease boundary lines and, when triggered, can incidentally result in circumstances which restrict or even prevent a lessee from further developing of the leasehold by requiring off-set well distances from the newly-created lease lines reducing the number of proven and available, but unrealized and undrilled, wellbore locations.

III. TRIGGERING RETAINED ACREAGE PROVISIONS

Retained acreage provisions may be triggered automatically or require the lessee/assignee to deliver a release or partial release. Triggering may occur at an event certain or one of two (or more) events certain, depending on how the triggering event is drafted. Automatic termination provisions should be clearly distinguished from release or partial release obligation requirements.

Typical examples of triggering language for retained acreage provisions in leases include the following:

- "... at the expiration of the primary term of the lease ..." (one event certain).
- "... at the expiration of the primary term or the conclusion of the continuous development program, whichever is the later to occur ..." (one of two alternative events certain).
- "...2 years after the expiration of the primary term or the conclusion of the continuous development program, whichever is the later to occur . . ." (one of two alternative events certain after a time-period postponement).
- "...5 years after the expiration of the primary term . . ." (one event certain after a time-period postponement).

To avoid confusion over the precise time and date retained acreage provisions trigger, the provisions must

⁴ *Compare* Mathis v. Texas Int'l Petroleum Corp., 627 F.Supp. 759 (W.D. Tex. 1986) (holding the Pugh clause was not triggered because the land subject to the lease was not properly pooled) *with* SMK Energy Corp. v. Westchester Gas Co., 705 S.W.2d 174, 176 (Tex. App.—Texarkana 1985, writ ref'd n.r.e.) (stating that Pugh clauses or Freestone riders "provide generally that if a portion of the leased premises is pooled with other land, production from that pooled unit will perpetuate the lease beyond the primary terms only as to the acreage which is actually included in the pooled unit").

be carefully and clearly drafted. The triggering event should not be uncertain nor out of sync with the remaining lease/contract provisions. The El Paso Court of Appeals issued an opinion illustrating confusion which arose over the triggering of a depth severance provision. In Community Bank of Raymore Chesapeake Exploration, L.L.C., ⁵ the lease v. contained the following provisions:

At the expiration of the Primary Term or the conclusion of the continuous development program, this Lease shall terminate as to all of the leased Oil and Gas rights in all formations below the depth of 100 feet below⁶ the stratigraphic equivalent of the base of the deepest formation from which the Lessee is then producing Oil and/or Gas in paying quantities from a well or wells located on such proration or producing unit.⁷

During the primary term, Chesapeake drilled and completed thirteen producing wells and complied with the continuous development program specified in the lease.⁸ However, when the primary term expired, Community Bank of Raymore ("CBR") requested Chesapeake release certain deep rights asserting the depth severance provisions had been triggered upon the expiration of the primary term rather than upon the end of the continuous development period.⁹ The trial court disagreed and concluded that the provisions had not been triggered because there had been no cessation in continuous development and, therefore, there was no partial termination of the lease.¹⁰

On appeal, the court considered the word "or" in the depth severance provisions. According to the court, the term "or" is disjunctive meaning its use in the clause allows the trigger to operate *either* at the expiration of the primary term or the conclusion of the continuous development program.¹¹ The court rejected CBR's contention that the depth severance had been triggered because there had been no cessation in continuous development and because it makes little

commercial sense.¹² The goal of this clause is to foster reasonable development and CBR's interpretation of the clause would have the opposite effect.¹³

In Endeavor Energy Resources, L.P. v. Discovery *Operating, Inc.*,¹⁴ the leases held by Endeavor Energy Resources, L.P. ("Endeavor") contained a continuous development provision stating "[a]t the expiration of the Primary Term hereof, this lease shall automatically terminate as to each proration unit upon which there is no well or wells thereon located ... unless Lessee is then engaged in drilling or reworking operations in accordance with the other provisions hereto."¹⁵ This provision further provided if the lessee, at the end of the primary term, is reworking operations or engaged in drilling, "this lease shall remain in full force and effect as to all proration units so long as ... not more than one-hundred twenty (120) days shall elapse from the completion of one well to the commencement of the following automatic termination provisions:

At the end of the Primary Term or upon the cessation of the continuous development of the Leased premises required above, whichever is later, this lease shall automatically terminate as to all lands and depths covered herein, save and except those lands and depths located within a governmental proration unit assigned to a well ... and the depths down to and including one hundred feet (100') below the deepest productive perforation(s), with each such governmental proration unit to contain the number of acres required to comply with the applicable rules and regulations of the Railroad Commission of Texas for obtaining the maximum producing allowable for the particular well.¹

During the primary term, Endeavor drilled and completed four producing wells, but did not drill any wells in 2 different quarter sections (the "disputed quarter sections").¹⁸ The Court of Appeals looked at the automatic termination provisions and its trigger at

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⁵ Cmty. Bank of Raymore v. Chesapeake Exploration,

L.L.C., 416 S.W.3d 750 (Tex. App.-El Paso 2013, no pet. h.).

⁶ A discussion behind the reasoning for the 100-foot interval is laid-out further-below.

Cmty. Bank of Raymore, 416 S.W.3d at 752.

⁸ Id.

⁹ Id.

¹⁰ *Id.* at 754.

¹¹ Id. at 755–56. ("[W]hen these clauses are harmonized and construed so that each has some effect, the result is that the horizontal Pugh clause can and will operate at the end of the primary term if production in paying quantities exists but no continuous development program is in place.")

¹² *Id.* at 756.

¹³ *Id.* ("[A] lessee will be disinclined to continue to develop a lease if the non-drilled portion of the lease will expire regardless of development during the extended primary term." (quoting Egeland v. Continental Resources, Inc., 616 N.W.2d 861, 870 (N.D. 2000))).

¹⁴ Endeavor Energy Res., L.P. v. Discovery Operating, Inc., 448 S.W.3d 169 (Tex. App.—Eastland 2014, pet. filed). ¹⁵ *Id.* at 172.

¹⁶ Id.

 $^{^{17}}$ Id.

¹⁸ *Id*.

the end of the primary term or upon the cessation of the continuous development, whichever is later.¹⁹ Since 120 days had elapsed from the completion of one well to the commencement of another well on these disputed quarter sections, the provisions were triggered. Therefore, the court found the lease terminated on the date the continuous development period ended as to the lands in the disputed quarter sections.²⁰

In connection with drafting retained acreage provisions, the triggering event should be a clearlydefined single event unambiguously setting-out the intent of the parties (or the same recurring event applied to different lands in a farmout agreement, term assignment, etc.). The phrase "whichever occurs later" should be included if the triggering event contains either/or events and, by including this phrase, the drafter should be able to obviate any confusion or dispute.²¹ It is crucial for practitioners to communicate with clients about retained acreage provisions during negotiation of their clients' leases or contracts to determine their clients' intentions and properly reflect their intentions in the leases/contracts. Alternatively, if the leases/contracts are already effective, practitioners should advise their clients of potential triggering event ambiguities ensuring their clients properly amend the affected leases/contracts prior to their clients' commencement of operations thereunder.

IV. PARTIAL TERMINATION OF ACREAGE

Although retained acreage provisions and partial termination of lease provisions are generally not favored by lessees, they are often a necessary concession in order to acquire an oil and gas lease. Since the provisions cause undeveloped portions of the lease to terminate, care must be taken to ensure the target geologic-stratigraphic intervals desired and acquired by a lessee are covered by the lease and will be retained in the lease upon lessee's actual development.

Conversely, the Lessor's viewpoint is that any portion of their lands not developed within the primary term or through continuous operations should expire and become available for another lessee to have the opportunity to develop the oil and gas. Care should be taken by the lessor's representative to not create a scenario where the lessee's ability to develop becomes frustrated or impossible once the provisions trigger.

When retained acreage provisions are triggered, an assessment of what acreage is developed and retained versus what acreage is undeveloped and terminates (or must be released) should be made by the parties to the lease/contract. Retained acreage on a surface basis may include all depths below the surface of the Earth, or cover limited depths (if on a depthdependent basis), or be limited to certain geologic formations (if on a stratigraphic-dependent basis).

a. Special Limitation on the Grant

The main duty of the court when interpreting an oil and gas lease is to determine the parties' intent as conveyed within the four corners of the lease.²² In seeking to determine the parties' intent, "the court must attempt to harmonize all parts of the lease, even if different parts of the lease appear contradictory or inconsistent."²³ By giving effect to all of the lease's provisions, the court honors the parties' intent of every clause having some effect and in some manner evidencing their agreement.²⁴ Therefore, the court should not strike out any part of the lease, unless there is a conflict where one part of the lease effectively destroys another part of the lease.²⁵

In Texas, "a habendum clause referring to 'said land' extends the lease to all the leased property while production of oil or gas occurs anywhere on the property during the second term."²⁶ Accordingly, "in the absence of anything in the lease to indicate a contrary intent, production on one tract will operate to perpetuate the lease as to all tracts described therein and covered thereby."²⁷ Under Texas law, the grant in an oil and gas lease is considered indivisible, unless a contrary intention is expressed. A contrary intention expressed in a lease is a special limitation of the grant.

When a lease terminates "is always a question of resolving the intention of the parties from the entire instrument."²⁸ "However, we will not hold the lease's language to impose a special limitation on the grant unless the language is so clear, precise, and unequivocal that we can reasonably give it no other meaning."²⁹

In order to ensure the lease/contract will be enforceable as written, the lease/contract should

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¹⁹ *Id.* at 175.

²⁰ *Id.* at 178.

²¹ Mark W. Hanna, *Drafting Traps in the Modern Oil & Gas World*, STATE BAR OF TEXAS, 32ND ANN. ADVANCED OIL, GAS & ENERGY RES. LAW COURSE 1 (Oct. 2, 2014).

²² Luckel v. White, 819 S.W.2d 459, 461 (Tex. 1991).

²³ Chesapeake Exploration, L.L.C. v. Energen Res. Corp.,
445 S.W.3d 878, 882 (Tex. App.—El Paso 2014, no pet. h.)
(citing Luckel v. White, 819 S.W.2d 459, 461–62 (Tex. 1991)).

²⁴ *Luckel*, 819 S.W.2d at 462.

²⁵ Anadarko Petroleum Corp. v. Thompson, 94 S.W.3d 550, 554 (Tex. 2002).

²⁶ Chesapeake, 445 S.W.3d at 882 (citing Ridge Oil Co., Inc. v. Guinn Invs., Inc., 148 S.W.3d 143, 149 (Tex. 2004)).

²⁷ Matthews v. Sun Oil Co., 425 S.W.2d 330, 333 (Tex.

^{1968).}

 ²⁸ *Thompson*, 94 S.W.3d at 554.
 ²⁹ *Id*.

contain sufficient definitions which operate with the retained acreage and other special provisions so that the parties do not have to look beyond the four corners of the lease for its construction. There is little Texas case law which construes retained acreage provisions solely from the terms and provisions contained in the lease/contract. However, when these leases/contracts refer to and incorporate by reference to rules, regulations, terms and definitions of terms from outside of the instrument itself, there is more Texas case law.

b. Integrating Railroad Commission of Texas Terminology

The practitioner must also know how to recognize and properly define the types of developed acreage blocks, or producing units, in order to prevent inadvertent results by operation of the retained acreage provisions. When retained acreage provisions refer to and incorporate (by reference) Railroad Commission of Texas rules, regulations and/or terms, understanding the full import of these references is crucial. For example, in regulatory usage, the term "unit" has various meanings and it is essential to distinguish the specific, intended meaning when drafting or interpreting retained acreage provisions.

The Commission's primary mission in its regulation and ensuring orderly production of oil and gas is to prevent waste of natural resources and to protect the correlative rights of citizens. The Commission's mechanisms for accomplishing its mission is by use of allowables and implementation in field rules. Allowables assigned to oil and gas wells prevent waste and protect correlative rights by fairly distributing the available market for production from the reservoir.³⁰ Allowables are allocation formulas employed by the Commission assigned to wells and can only be assigned to each well on a well-by-well basis regardless if wells are completed in the same reservoir.³¹ The allocation formulas may be based on a number of factors, including productive acreage, initial potential, net-acre feet, deliverability, pressure, and/or combinations of the same.³² However, in many fields Texas, the allocation formulas have been in indefinitely suspended and wells are operating under Absolute Open Flow (AOF). The reason for the suspension of the allocation formulas is that, in many fields, operators have a market for 100% of the deliverability of their respective wells. In the event an

allocation formula for a particular field includes both density provisions and an allocation based partially or entirely on acreage, then operators in the field must file certified plats showing the size and shape of the acreage assigned to each well indicating the acreage considered reasonably productive (Form P-15, Statement of Productivity of Acreage Assigned to Proration Units).

The Commission's implementation of field rules uses well spacing and density to promote development of a field in a manner so that wells are drilled in a way which does not damage the reservoir.³³ This includes a minimum distance between a well with respect to lease lines, property lines, subdivision lines, and to other wells. Each field usually has its own specific lease line and density provisions; however, if no specific field rules exist, then the lease lines spacing is handled under Statewide Rule 37³⁴ and density is handled under Statewide Rule 38.³⁵ Field rules are comprised of Statewide Rules, County Regular Rules, and Special Field Rules.

Most oil and gas fields in Texas are governed by Statewide Rules. Statewide Rules include 467 feet lease line spacing, 1,200 feet well spacing, and forty (40) acres density. County Regular Rules or District Spacing Rules, applicable only in Railroad Commission Districts 7B and 9, and in Mcculloch County located in District 7C. District Spacing Rules applies where completions are at depths of 5,000 feet or less; completions deeper than 5,000 feet apply Statewide Rules. Here, time drafting and/or interpreting retained acreage provisions in these counties may be problematic if the lease/contract integrates Commission terminology but does not account for the different, shallower District Spacing Rules compared to the deeper Statewide Spacing Rules.

Special Field Rules are developed and related to geologic conditions in the reservoir formation within a specific field. Special Field Rules may be implemented after application and identification of a correlative interval in well logs filed with the Commission.³⁶ Special Field Rules often affect the size of the pooled units and proration units an operator may create based on the lease's retained acreage

³⁰ 16 TEX. ADMIN. CODE § 3.52 (West 2015).

³¹ 16 TEX. ADMIN. CODE § 3.40(d) (West 2015).

³² Scott C. Petry, *Drafting the Retained Acreage Clause: The Effect of Governmental Authority on Retained Acreage*, STATE BAR OF TEXAS, 27TH ANN. ADVANCED OIL, GAS AND ENERGY RESOURCES LAW COURSE 1 (Oct. 8–9, 2009).

³³ *Id.* at 2.

³⁴ 16 TEX. ADMIN. CODE § 3.37 (West 2015). Well spacing specifies the minimum distance required between two wells in the same reservoir and the minimum distance required between a well and property lines, lease lines, or subdivision lines.

³⁵ 16 TEX. ADMIN. CODE § 3.38 (West 2015).

³⁶ 16 TEX. ADMIN. CODE § 3.41 (West 2015).

provisions incorporating "governmental authority" in the pooling and/or retained acreage provisions.

Although the Commission regulates development and production, it does not have the authority to adjudicate property or contract rights and it will usually refuse to rule until a court adjudicates the lease/contract dispute through to a judgment after which the Commission may act.

It is suggested that, to avoid creating unintentional consequences when drafting and/or interpreting retained acreage provisions tied to rules of the "governmental authority having jurisdiction", the practitioner should understand and know the allowables, if applicable. In printed lease forms, pooling provisions can be tied to unit sizes required under governmental rule or order, for the drilling or operation of a well of regular location, or for obtaining maximum allowable from any well to be drilled...any such unit may be established or enlarged to conform to the size *required* by such governmental order or rule. Here, a two-step process of evaluating the provision includes whether productive acreage is a component of the allowable and verifying that additional acreage is actually necessary or required to achieve the maximum It may be necessary to consult with allowable. geologists and/or engineers of your client to determine whether the acreage under the maximum allowable is indeed necessary to achieve the full allowable rate. If technical evidence shows a well is draining a certain amount of acreage, but the operator intends to claim more than that amount, the operator may open itself up to claims that it is not acting in good faith in purporting to retain a substantially greater amount of acreage.

Not all maximum allowable clauses result in greater retained acreage other than what is provided for in the lease. Certain field rules may not grant additional acreage under maximum allowables. The instance of the County Field Rules (referenced above) may actually provide for less acreage to be retained than typical retained acreage provisions (10 acres or 20 acres for shallow wells – less than 5,000 feet deep, and not the 40 acres for an oil well or the 320 acres or 640 acres for a gas well in most printed lease forms).

If retained acreage provisions are tied to the same pooled unit acreage quantum as the pooling provisions under printed form leases, the lease forms being implemented or interpreted are important. Examples include a Producers 88 (7-69) lease form which uses "required" language, compared to a Producers 88 (4-76) lease form which uses "prescribed or permitted" language.

A practitioner should always be wary of the possible effects of including language such as "required", or "prescribed" and/or "permitted" by "governmental authority" language. In *Jones v*.

Killingsworth, ³⁷ the lease at issue contained the following pooling language:

Units pooled for oil hereunder shall not substantially exceed 40 acres each in area, and units pooled for gas hereunder shall not substantially exceed in area 640 acres each plus a tolerance of 10% Thereof, provided that should *governmental authority* having jurisdiction *prescribe or permit* the creation of units larger than those specified, units thereafter created may conform substantially in size with those *prescribed* by governmental regulations.³⁸

The court stated the RRC rules governing the field in question have the power to permit "only one well to each eighty (80) acre proration unit." ³⁹ The rules further allow the RRC to assign not more than eighty acres of additional acreage. ⁴⁰ "The fact that the Railroad Commission may Permit a much larger unit cannot be read into the lease contract when, as here, the authority to create larger units is expressly limited to units of the size Prescribed by the Railroad Commission."⁴¹ Here, the RRC prescribed an eighty-acre unit. ⁴² Thus, the court found the "prescribed" language to control and prevented the additional acreage beyond the *prescribed* eighty acres from being retained. ⁴³

Jones evidences that the use of "prescribed" and "governmental authority" language can be restrictive and not desired. Substituting "prescribed" with "prescribed or permitted" is a common practice which allows additional acreage to be retained beyond the amount prescribed by the Commission.⁴⁴ Tying the retained acreage quantum to acreage "required" produces similar undesired restrictions. Alternatively, tie the retained acreage quantum to the amount of acreage "permitted" by the Commission to be assigned to a well.⁴⁵

³⁷ Jones v. Killingsworth, 403 S.W.2d 325 (Tex. 1965).

³⁸ *Id.* at 326–27 (emphasis added).

³⁹ *Id.* at 327.

⁴⁰ *Id.* at 328. "The field rules clearly say that there Must be a proration unit of at least 80 acres, and there May be larger units of not more than [160] acres."

 $^{^{41}}_{12}$ Id.

⁴² *Id*.

⁴³ *Id*.

⁴⁴ See Petry, supra note 32, at 6.

⁴⁵ "A fixed amount of acreage is even better as long as the fixed amount is at least equal to or greater than the amount allowed by the RRC rules." H. Philip Whitworth, *Land and Regulatory Problems Related to Horizontal Wells in Texas*, OIL & GAS REGULATION IN TEXAS 21 (Apr. 14, 2011).

Many retained acreage provisions provide for the lessee to have a proration unit assigned to each producing well. In certain situations, the field rules require the operator to file a plat with the RRC assigning a proration unit to each well. However, certain special field rules, such as Newark (Barnett Shale) Field's special rules, suspended the requirement for filing a plat including the acreage assigned to each well so long as the allocation formula for the field continues to be suspended.⁴⁶ This gives the operator the option of filing a plat resulting in many plats not being filed for wells in those fields.

In another example, under the amended Field Rules for the Spraberry Field, the largest unit which could be formed and acreage retained by the drilling of a single horizontal well under the *Jones* lease provision is eighty acres. But, if the lease was written (or amended) for the provision to read:

Should the Railroad Commission of Texas or other governmental authority having jurisdiction, by rule or order, prescribe or permit the creation of larger units, all units created hereunder shall conform substantially in size with those prescribed or permitted by such governmental authority

The amended provision would allow or permit an operator to retain a maximum of 480 acres if the lateral drilled was 7,000 feet and the distance between the first take point and last take point was 6,500 feet. The formula for calculating the amount of acreage which can be retained under the Field Rules is, as follows: A (acreage) = 80 (standard drilling and proration unit for an individual well) + 80 (acreage tolerance) + (additional acreage allowed under Statewide Rule 86 (d)(1) after determining the distance from first take point to last take point).

In October 2014, the Eastland Court of Appeals issued an opinion showing the importance of filing a certified proration plat with the Railroad Commission if the lease requires this filing in order to hold the specified lands and depths. In this case, Discovery Operating, Inc. ("Discovery") and Patriot Royalty and Land, LLC ("Patriot") brought a trespass to try title action against Endeavor claiming Endeavor's leases had partially terminated as to the NW/4 of Section 9 and the SW/4 of Section 4 (the "disputed quarter sections").⁴⁷ Endeavor asserted their leases remained in full force and effect as to the disputed quarter sections.⁴⁸ During the primary term, Endeavor drilled

and completed four producing wells (the "Endeavor Wells"), but did not drill any wells in the disputed quarter sections.⁴⁹ These Endeavor Wells were producing oil from the Spraberry (Trend Area) Field meaning production from this field is governed by special field rules promulgated by the RRC.⁵⁰

Rule 3 of the applicable RRC field rules relates to acreage assigned to wells and provides that acreage assigned to an individual well shall be known as a proration unit. A standard proration unit is to be eighty acres, but operators may elect to assign not more than eighty acres to a well on an eighty-acre unit or cumulatively not more than one hundred and sixty acres. Rule 3 further requires an operator to file certified plats with the RRC specifying the amount of acreage allotted for each well.⁵¹

After the Endeavor Wells were completed, Endeavor filed certified plats with the RRC for each well, but did not assign any portion of the acreage in the disputed quarter sections.⁵² Since the disputed acreage was outside of the assigned proration units Endeavor had designated with the RRC, Patriot asserted Endeavor's leases had automatically

The acreage assigned to an individual well shall be known as a proration unit. The standard drilling and proration units are established hereby to be EIGHTY (80) acres. No proration unit shall consist of more than EIGHTY (80) acres except as hereinafter provided. . . . All proration units shall consist of continuous and contiguous acreage which can reasonably be considered to be productive of oil. No double assignment of acreage will be accepted.

Notwithstanding the above, operators may elect to assign a tolerance of not more than EIGHTY (80) acres of additional unassigned lease acreage to a well on an EIGHTY (80) acre unit and shall in such event receive allowable credit for not more than ONE HUNDRED SIXTY (160) acres.

Operators shall file with the Commission certified plats of their properties in said field, which plats shall set out distinctly all of those things pertinent to the determination of the acreage credit claimed for each well.

Id.

⁵² *Id.* at 173–74. Endeavor did admit it had mistakenly included incorrect amounts of acreage in the proration units in the certified plats, and subsequently sought RRC approval of different plats in which Endeavor attempted to change the acreage in the proration units. *Id.* at 174. The RRC rejected Endeavor's requests to change the acreage assigned to each proration unit because of the pending litigation between Endeavor and Discovery. *Id.*

⁴⁶ See Hanna, supra note 21, at 3.

⁴⁷ Endeavor Energy Res., L.P. v. Discovery Operating, Inc.,
448 S.W.3d 169, 171 (Tex. App.—Eastland 2014, pet. filed).
⁴⁸ *Id.*

⁴⁹ *Id.* at 172.

⁵⁰ *Id.* at 173.

⁵¹ Relevant parts of Rule 3 are stated in *Endeavor Energy Res., L.P. v. Discovery Operating, Inc.*

terminated as to the disputed quarter sections.⁵³ The trial court agreed with Patriot and the Eastland Court of Appeals affirmed.

The Court of Appeals looked at the automatic termination of acreage provisions and its trigger at the end of the primary term or upon the cessation of the continuous development, whichever is later.⁵⁴ As previously stated, this clause provides the lease will automatically terminate as to all lands except those designated in the governmental proration unit.⁵⁵ Therefore, the court found the lease terminated on the date the continuous development period ended as to the lands in the disputed quarter sections because they were not located in a governmental proration unit assigned by Endeavor to a well.⁵⁶

The parties in Endeavor pointed the court to another recently-issued opinion by the El Paso Court of Appeals. In *Chesapeake Exploration*, L.L.C. v. *Energen Resources Corp.*,⁵⁷ the issue was whether, under the retained acreage clause, the leases had partially terminated as to certain acreage.⁵⁸ The leases in this case provide when continuous development ends, the lease will terminate as to all acreage except for "each proration unit established under ... [the] rules and regulations [of the RRC ...] upon which there exists (either on the above described land or on lands pooled or unitized therewith) a well capable of producing oil and/or gas in commercial quantities ... **,**, 59 Different from Endeavor, the operators in Chesapeake had designated all of the leased acreage as the proration unit filed with the RRC before the end of the continuous development period. In determining the parties' intent, the court looked at the plain, grammatical language of the lease. The language showed "the parties intended the leases to continue as to each designated proration unit if the unit had a well capable of producing gas in commercial quantities when continuous development ceased."⁶⁰ Therefore, the leases had not partially terminated as to the disputed acreage.⁶¹

For Endeavor to have retained the acreage in the disputed quarter sections, such acreage should have been included in the certified plats filed with the RRC for these two wells.

It has been pointed-out, and it is worth repeating, that one of the most prevalent methods of creating unintended consequences in retained acreage provisions is failure to properly define the term "unit" or "units" under a lease/contract. The term "unit" has different meanings in the regulatory context and failure to expressly define the term within the lease/contract may unintentionally integrate regulatory definitions.

- "Drilling unit" definition- a "drilling unit" is the "acreage assigned to a well for drilling purposes" ⁶² and contains the acreage filed with the RRC Form W-1 drilling permit to illustrate adequate acreage for density requirements. ⁶³ This is a regulatory term with a limited purpose and is not required on vertical well permits anymore. ⁶⁴
- "Proration unit" definition- a "proration unit" is the "acreage assigned to a well for the purpose of assigning allowables and allocating allowable production to the well."⁶⁵ The actual formation of a proration unit depends on situations where acreage is used as part of the calculation of the allowable.⁶⁶ Acreage is not always used as a factor in allowables.⁶⁷
- "Pooled unit" or "voluntary pooled unit" definition- a "voluntary pooled unit" or "pooled unit" is "the acreage formed by joining separately owned tracts, usually to constitute a drilling or prorationing unit". ⁶⁸ This is the Pooled Unit Declaration filed in the official public records of the county where the land is located. ⁶⁹ It is essential to note that a Voluntary Pooled Unit submitted to the courthouse as a Unit Declaration is NOT considered the same as the pooled unit submitted with the Commission on the Form P-12, Certificate of Pooling Authority (the "P-12"). ⁷⁰ These could, however, cover the same acreage and unit, but filing a Form P-12 is considered

⁶⁶ See Petry, supra note 32, at 6.

⁵³ *Id.* at 174.

 $^{^{54}}$ *Id.* at 175.

⁵⁵ *Id.* at 175–76.

 $^{^{56}}$ *Id.* at 178. The court stated "it [was] not the failure to designate the larger proration unit that automatically terminate[d] the lease as to the disputed quarter sections; the automatic termination [was] the result of the lease terms. The failure to designate the additional acreage merely quantifie[d] the amount of acreage as to which the lease provide[d] for automatic termination."

 ⁵⁷ Chesapeake Exploration, L.L.C. v. Energen Res. Corp.,
 445 S.W.3d 878, 880 (Tex. App.—El Paso 2014, no pet. h.).
 ⁵⁸ *Id.* at 880.

⁵⁹ *Id.* at 879.

 $^{^{60}}$ *Id.* at 883.

⁶¹ *Id.* at 886.

⁶² 16 TEX. ADMIN. CODE § 3.38(a)(2) (West 2015).

⁶³ *See* Petry, *supra* note 32, at 6 (citing 16 TEX. ADMIN. CODE § 3.38 (West 2015)).

⁶⁴ Id. (citing 16 TEX. ADMIN. CODE § 3.35(h) (West 2015)).

⁶⁵ 16 TEX. ADMIN. CODE § 3.38(a)(3) (West 2015).

⁶⁷ Id.

⁶⁸ 2 ERNEST E. SMITH & JACQUELINE LANG WEAVER, TEXAS LAW OF OIL AND GAS § 10.1(B) (2d ed. 2007).

⁶⁹ See Petry, supra note 32, at 6.

 $^{^{70}}$ *Id.* at 6–7.

regulatory while filing a Pooled Unit Declaration filed at the courthouse is considered contractual.⁷¹

"Force pooled unit" definition- "a 'forced pooled' unit is the joining of separately owned tracts under Chapter 102 of the Texas Natural Resources Code, or the Mineral Interest Pooling Act ('MIPA')."⁷² MIPA allows the Commission to force pool adjacent interests and tracts under limited circumstances in order to reach a proration unit size called for in the appropriate field rules.⁷³

c. Memorializing the Retained and Released Lands.

Retained acreage provisions are sometimes drafted such that the lessee is required to designate the developed acreage associated with each producing well whereas other retained acreage provisions obligate the lessee to release the undeveloped acreage. The method of and location for making such designations vary widely. The operator may be required to file a description of the developed acreage being retained in the appropriate county clerk's records, but others are required to be filed with the Railroad Commission's records. In the former situation, the operator should cause a producing unit declaration or designation to be filed containing a description of the lease, a metes and bounds description of the developed acreage or productive acreage being assigned to the well, including the total developed and retained acreage amount, and/or contain a plat depicting amount and approximate location of the developed acreage. The quantum of developed and retained acreage should comply with the retained acreage provisions. If limited retained depths are included, these details may be added to the declaration or designation. Conversely, if retained acreage is not to be specifically designated, but released acreage and/or depths must be filed for record pursuant to the retained acreage provisions, it is recommended that the developed acreage assigned to the well is filed with the Commission at the same time the developed acreage and depths being released are filed in the appropriate county clerk's records; the reciprocal instruments matching precisely insofar as what is being retained and released. So, it is advisable for an operator to ensure retained developed acreage or productive acreage around a well is assigned by a Form P-12 (for a pooled unit) or Form P-15 (for a proration unit) filed with the Railroad Commission and complies with the retained acreage provisions integrating regulatory rules, regulations and/or terms complying with the appropriate field rules and allowables, if applicable.

V. PARTIAL TERMINATION OF DEPTHS/STRATIGRAPHIC INTERVALS

Depth severance provisions have become commonplace in leases, farmouts, etc. They often provide the lease/contract terminates as to certain depths when continuous development has ceased. These provisions may be formulated in different ways. Some include releasing all depths below the deepest depth drilled in the well, or the deepest perforation, or the deepest producing formation, or usually some other depth-dependent feature. Additionally, depth severances may provide all depths above and/or below the producing formation, zone, horizon, perforations, or producing/productive interval terminate or are to be released. Drafting or interpreting such provisions should include careful identification and description of the depths/stratigraphic intervals being retained or terminating.74

a. Depth severance provisions

In Community Bank of Raymore, the depth severance provisions also contained a reference to the "stratigraphic equivalent of the base of the deepest formation from which the Lessee is then producing Oil and/or Gas in paying quantities from a well or wells located on such proration or producing unit." CBR argued (alternatively, if the Pugh clause was never triggered) that rights to the undeveloped, deep-lying formations in Block Two terminated nevertheless because the continuous development program required the development of lands situated in a "proration unit" and Chesapeake was not developing land so situated.⁷⁵ In any event, the retained acreage and depth severance provisions never triggered due to the fact that Chesapeake was found to have perpetuated the lease by its continuous operations.⁷⁶

In EOG Resources, Inc. v. Wagner & Brown, Ltd.,⁷⁷ the parties were the successors-in-interest to the parties to a Farmout Agreement.⁷⁸ The relevant portion of the Farmout Agreement relating to the transfer of rights provided:

⁷¹ *Id.* at 7.

 $^{^{72}}$ Id.

 $^{^{73}}$ *Id.*

⁷⁴ See John B. McFarland, *Oil and Gas Lease Basics*, STATE BAR OF TEXAS, REAL ESTATE LAW 101 25 (July 9, 2014). "The Lessee will want to retain the deepest depths possible, and will suggest that it be entitled to retain all depths down to the depth of the deepest depth drilled in any well on the

lease." *Id.* On the other hand, the Lessor will want the depth to be based on the deepest perforation from which it is producing.

⁷⁵ Cmty. Bank of Raymore v. Chesapeake Exploration,

L.L.C., 416 S.W.3d 750, 753 (Tex. App.—El Paso 2013, no pet. h.).

 $^{^{\}hat{7}6}$ *Id*. at 755.

⁷⁷ EOG Res., Inc. v. Wagner & Brown, Ltd., 202 S.W.3d 338 (Tex. App.—Corpus Christi 2006, pet. denied).

⁷⁸ *Id.* at 340.

"The Assignment provided for above shall be limited to 100 feet below the deepest producing interval as obtained in the test well, shall be without warranty either express or implied and shall reserve to Longhorn all rights below the assigned depths, together with such rights as are necessary to Longhorn's full enjoyment of the reserved deeper rights."79

REH drilled a successful test well, complied with all of Longhorn's specifications, and earned an assignment of the interest in the leases as provided in the Farmout Agreement.⁸⁰ The undisputed fact is that the test well ("Well No. 1") produced at depths between 9,679 feet and 9,729 feet.⁸¹ In 2002, a dispute arose subsequent to Longhorn's acquisition by Wagner & Brown, Ltd., and REH's acquisition by EOG Resources, Inc., when EOG sought to drill a second well.⁸² EOG's title research discovered unrecorded assignments from 1985 which altered the horizontal boundary in the Farmout Agreement; the 1985 assignments conveyed REH's rights to "the vertical interval from the surface to the depth of 9, 779 feet subsurface."⁸³

The parties executed Correction Assignments in connection with the Farmout Agreement which changed the language in the 1985 assignments regarding the depth limitation returning it back to "100 feet below the deepest producing interval as obtained in the test well."⁸⁴ The dispute arose over the construction of this phrase.⁸⁵

EOG contends that the language "deepest producing interval" as using the Farmout Agreement and Correction Assignment refers to the formation from which Well No. 1 first established production, at whatever depth such interval is found.⁸⁶ According to EOG's geologists, Well No. 1's deepest producing interval is in the subsurface geologic formation known as the Morris Sand.⁸⁷ In October 2002, EOG drilled Well No. 2. located 2,800 feet to the north of Well No. 1, into the Morris Sand, where it began producing.⁸⁸ However, Well No. 2 produced at depths between 10,230 feet and 10,266 feet, most likely because of geological faulting and structural dip in the Morris Sand Formation.⁸⁹ EOG contended that, since Well

- ⁸¹ *Id*.
- ⁸² Id.
- ⁸³ *Id*.
- ⁸⁴ Id. ⁸⁵ Id.

- ⁸⁷ Id.
- ⁸⁸ *Id*.
- ⁸⁹ Id.

No. 1 produced from an entire underground formation, its interest followed the formation to its deepest part, plus 100 feet: such instruction necessarily meaning that the depth limitation is a variable number.⁹⁰ In November 2002, Wagner & Brown filed a suit for declaratory judgment for construction of the Farmout Agreement and Correction Assignment.⁹¹ The trial court granted Wagner and Brown's Motion for Summary Judgment declaring that the interest of EOG is limited to those depths lying between the surface and a subsurface depth of 9,829 feet in the properties covered thereby.⁹² Both parties contended that the Farmout Agreement and Correction Assignment were unambiguous.⁹³ The Court of Appeals agreed there was no ambiguity.⁹⁴ The Court of Appeals applied the plain, ordinary and generally-accepted of the meaning of the terms in the contract, as expressed in the final Correction Assignment.⁹⁵ The Court held that the qualifying language "deepest producing interval as obtained in the test well" was not the operative language, but rather the interest EOG was conveyed under the Correction Assignment, defined as "all depths from the surface of the ground down to 100 feet below the deepest producing interval as obtained in the test well."

EOG's argument relied extensively on the Louisiana case of Sandefer Oil & Gas, Inc. v. Duhon⁹⁶ which surrounded construction of a clause which provided "[a]fter expiration of the primary term, this lease will terminate automatically as to all horizons situated 100 feet below the deepest depth drilled (a) from which a well located on the land or acreage pooled therewith is producing in paving quantities⁹⁷ In Sandefer, the well was drilled to a depth of 17,609 feet, but produced from perforations between 17,090 feet and 17,200 feet, being the Middle Miogypsionoides Sand. 98 Approximately 50 feet below that formation, separated by a shale layer, was the lower Miogypsionoides Sand and the borehole of the well had pierced the same.⁹⁹ However, the well produced from the shallower formation and the trial court determined that the lease did not extend to 100 feet below the lower formation because of the language the parties used in their agreement.¹⁰⁰ In Sandefer, the

⁹⁰ Id.

- 96 Sandefer Oil & Gas, Inc. v. Duhon, 961 F.2d 1207 (5th
- Cir. 1992). ⁹⁷ *Id.* at 1208.

⁷⁹ *Id.* at 341.

⁸⁰ *Id*.

⁸⁶ EOG Res., Inc., 202 S.W.3d at 341.

⁹¹ *Id.* at 342.

⁹² *Id*.

 $^{^{93}}$ *Id.* at 344.

⁹⁴ Id.

⁹⁵ *Id.* at 345.

⁹⁸ Id.

⁹⁹ Id. at 1209. ¹⁰⁰ *Id*.

operative phrase was "as to all horizons", compared to "deepest producing interval as obtained in the test well" at issue here. In Sandefer, the Lessee retained rights to all depths to which Lessee drilled or tested, without reference to production.¹⁰¹ In EOG Resources, Inc., the Correction Assignment was found to have used clear language, specifically qualifying and tying the *depth* in issue to the test well.¹⁰² The Court of Appeals concluded that the trial court did not err in concluding that the Correction Assignment "did not enlarge or alter the rights owned by the parties and that the interest of EOG Resources under such Correction Assignment is limited to those depths lying between the surface and subsurface depth of 9,829 feet subsurface in the properties covered thereby."¹⁰³ The Court overruled EOG's issues on appeal.

The use of the term, "stratigraphic equivalent", can be problematic as it can create an ambiguity when determining the depths to be released and the depths retained under a lease/contract. To avoid this ambiguity and provide clarity, the drafter should attempt to include a detailed reference to a stratigraphic interval in a particular well log. Incorporating the date, well name, and API number of this specific well log can allay confusion or ambiguity. Also to avoid additional uncertainty, a practitioner, when possible, should reference a specific geological formation below which will be released. For example "all formations below the base of the deepest formation from which oil or gas is being producing in paying quantities." A drafter should include more specific language involving the name of the formation such as "the base of the Olmos Formation" where an identifiable formal formation is ascertainable.

Incorporating geological subdivisions of a formation should be avoided for a number of reasons. Definitions of the subdivisions of a formation such as "member", "horizon", "zone", "interval" and "strata" are very imprecise and, unless such term is defined or tied to a nearby well log. A difference of opinion between different geologists and/or geophysicists is common and the different opinions may extend to what is intended by use of such a term. If a dispute arises, it often ends with varying expert testimony. Bv integrating the term "formation", there is less likelihood for a dispute to arise as most formallynamed geologic formations are comprised of a certain rock type, laterally extensive, and contain well-defined upper and lower boundaries, called contacts, with other formally-named formations.

Unfortunately, using such terms is not always possible where productive geologic formations occur in thick sequences in certain basins. Again, explaining and defining the formation by tying the reference to strata or a datum in a nearby well log is useful.

Stratigraphic severance provisions b.

As briefly discussed in the foregoing section, severance provisions based on geology can be drafted so that the developing party retains all aspects of the geological formation which it has tested. Although no Texas case was found, a look at the Sandefer case from Louisiana proves to be beneficial. In Sandefer, the "Horizontal Pugh clause" provided that the lease would terminate automatically after expiration of the primary term, "as to all horizons situated 100 feet below the deepest depth drilled (a) from which a well located on the land or acreage pooled therewith is producing in the Horizontal Pugh clause in the Oil and Gas lease made a horizontal division of property subject to the lease, finding that the clause, by using the oil and gas lease term "horizon" did not mean a flat, parallel boundary line drawn a certain depth, but rather meant a body of material or stratum found below the Earth's surface, generally considered to be a bed of sand or other material which contains oil, gas and other minerals.¹⁰⁵ The Court in *Sandefer* found that, after the Horizontal Pugh clause triggered the lease automatically terminated as to all horizons situated 100 feet below the deepest depth drilled, being 100 feet below the bottom of the formation zone at which oil is being produced at whatever depth such point was found throughout the leased tract.¹⁰⁶ The Court noted that although the Lessors urged that the word "horizon" meant a flat parallel boundary line (or datum) which would be drawn at 17,350 feet, the parties intended for it to be defined consistent with usage of the term in the oil and gas industry being "a zone of a particular formation . . . of sufficient porosity and permeability to form a petroleum reservoir."¹⁰⁷ There, the horizontal lease boundary under the lands at issue was found to be 100 feet below the bottom of the Middle Miogypsionoides, at whatever depth it is found throughout the leased tract.¹⁰⁸

For the reasons in the example below, it is recommended that the practitioner prepare vertical severance provisions on a geologic/stratigraphicdependent basis rather than on a depth-dependent

¹⁰¹ *Id.* at 1211.

¹⁰² EOG Res., Inc. v. Wagner & Brown, Ltd., 202 S.W.3d 338, 346 (Tex. App.—Corpus Christi 2006, pet. denied). ¹⁰³ *Id.* at 346–47.

¹⁰⁴ Sandefer Oil & Gas, Inc. v. Duhon, 961 F.2d 1207, 1208 (5th Cir. 1992).

¹⁰⁵ *Id.* at 1211.

 $^{^{106}}$ Id.

¹⁰⁷ *Id*. ¹⁰⁸ Id.

¹¹

basis. Although there are very few cases construing depth severance provisions, it is likely that when a provision integrates the term "depth" relative to the vertical severance being defined, the vertical severance will take place on a depth-dependent basis. This creates an artificial horizontal datum without regard to the local geology encountered in the operator's development efforts. EOG Resources, Inc. illustrates this point and reveals that, despite the developing operator's efforts and resources to develop the prospect, the use of a depth-dependent datum created a situation where the developed formation was not retained simply because it was found to occur slightly deeper or down dip from the same retained formation in the prior, updip well. If the developing operator had retained all aspects of the developed formation with respect to all geologic conditions, such as geologic structure, dip of strata and/or faulting, its efforts to prove-up the formation would have been a retained benefit allowing it to further develop the same formation in the downdip strata.

An example for stratigraphic intervals to be retained: Your client is exploring for and developing the Wilcox Formation under lands. The new lease should provide that the entire thickness of the Wilcox Formation will be retained in the developed acreage This formation is complex. The Wilcox blocks. Formation strata dip or are inclined in a coastward direction (towards the Gulf of Mexico coastline) and can change suddenly and significantly across syndepositional or sedimentation-rate related faults, called growth faults. This often results in substantial expansion of the Wilcox Formation on the downthrown side of a growth fault. If the Wilcox Formation is 300 feet in thickness on the upthrown side of the fault and proves to be productive, across the growth fault it may thicken to twice this amount or more, contain additional sands, and be more prolific at a depth a few hundred feet below it was found on the upthrown side If the new lease's retained acreage of the fault. provisions are depth-dependent, not geologicallydependent, the deeper, thicker, potentially-productive downthrown section of the Wilcox Formation under the lease/contract lands may be lost. Retaining all aspects of the target formation under the respective lease/contract may require substantial information from client geologists and/or engineers in order to properly draft or amend retained acreage (and other) provisions.

Another example for stratigraphic intervals to be retained: The initial, conventional development of the Austin Chalk Formation was through 1970's vintage leases. These leases often contain depth severance provisions whereby, at the end of the primary terms or cessation of continuous operations, the leases terminated insofar as all depths 100 feet below the base of the deepest producing formation. This resulted in

the top 100 feet of the Eagle Ford Formation being held under these leases. The additional 100 feet included in these depth severance provisions may have been necessary at that time for "rat hole", such as to properly log and produce vertical Austin Chalk wells. Typically, production was found in the lowermost portion of the Austin Chalk Formation and development through vertical wells included logging after drilling (as opposed to logging while drilling with horizontal wells). So these wells, logged after drilling was completed, required that the wells to be drilled 100 feet or more below the base of the Austin Chalk Formation so that the nearly 100-foot long logging equipment string could be fully in-place 100 feet below the base of the Austin Chalk Formation. Then, running or pulling electric log string upward and across the productive zone allowed for full and complete readings taken over the productive formation including its lowermost, productive portion. So, we see that this type of retained depths provision was then-necessary in the completing of vertical Austin Chalk wells. Later, when the Eagle Ford Formation became a target formation, the uppermost 100 feet of the Eagle Ford Formation was often held by production under these older leases. This created title and ownership problems that often restricted and sometimes prevented Eagle Ford Formation exploration and development. In some of these instances, it took years for the parties owning older leases retaining the uppermost 100 feet of the Eagle Ford Formation and parties owning new leases below the same to coordinate their exploration and development efforts without conflict.

VI. CONCLUSIONS

There is little Texas case law construing and interpreting retained acreage provisions. Good Texas case law has been developed regarding construction of pooling provisions, which provides substantial guidance towards drafting and interpreting retained acreage provisions notwithstanding the fact that the types of provisions technically operate differently.

In plays where leases are held by production from a formation or formations other than the formation which is the play, great care should be taken to fully evaluate and understand the lease forms of the HBP leases to ensure the client is able to acquire, develop and retain developed, producing properties as assets consistent with the client's business goals. In some instances, the HBP leases may contain very different terms and provisions from other HBP leases in the play and, therefore, should be closely scrutinized to evaluate their potential and, if necessary, amended to achieve the client's business goals.

In plays requiring new leases, such new leases will likely contain retained acreage and other related provisions, the retained acreage provisions may be

drafted in a manner consistent with the client's development goals and expectations from the outset, subject to being renegotiated on a lease basis. Here, retained acreage, pooling, depth severance and other special provisions may be prepared ensuring the client will be able to accomplish its business goals in acquiring, developing and retaining developed, producing properties as valuable assets. Specific circumstances, such as hold-out lessors, and leases acquired during development of the play may be customized on a case basis. But the company Landman and Attorney representing the client should ensure any special terms of such hold-out leases allow the client to develop and retain developed, producing properties consistent with its other developed, producing properties.

APPENDIX A

Freestone Rider or Pugh Clause was developed by attorneys representing landowners.¹⁰⁹

Additional retained acreage, or rather, severed acreage provisions have arisen, including provisions which are commonly called horizontal Pugh clauses and vertical Pugh clauses.¹¹⁰

¹⁰⁹ Bruce M. Kramer, *Oil and Gas Leases and Pooling: A Look Back and a Peek Ahead*, 45 TEX. TECH. L. REV. 877, 880 (2013). The Pugh clause is said to be named after Lawrence Pugh, a Louisiana attorney who developed the clause in 1947 to help counteract the Louisiana Supreme Court case, Hunter v. Shell Oil Co., 211 La. 893 (1947). 4 PATRICK H. MARTIN & BRUCE M. KRAMER, WILLIAMS & MEYERS OIL AND GAS LAW § 669.14 n.14 (LexisNexis Matthew Bender 2013). The *Hunter* Court found that production from a unit including a portion of a leased tract would maintain the lease in force as to all lands covered by the lease even if the lands are not contiguous. Hunter v. Shell Oil Co., 211 La. 893, 904–06 (1947). Since these portions of the lease not included in producing units were still held under the lease, lessors were left with large undeveloped acreage portions. This undeveloped acreage translated to lost income and lost opportunities to obtain additional bonus payments and royalty payments because their minerals remained undeveloped and could not be leased to a new lessee. This dilemma led to the development of the Pugh clause. Although Lawrence Pugh is considered to be the creator of the pugh clause, similar clauses were negotiated in leases before 1947. *See* Rist v. Westhoma Oil Co., 1963 OK 126, 385 P.2d 791, 794–95 (1963) (referring to the Pugh clauses contained in the lease and suggesting the first appearance of the Pugh clause was in 1941). Additionally, the term "Freestone rider" originated in Freestone County, Texas, where the term was in widespread use.

¹¹⁰ A horizontal Pugh clause has the "effect of severing a leasehold as to the pooled and non-pooled portions on the basis of horizontal planes" A vertical Pugh clause "has the effect of severing a leasehold on the basis of vertical planes only." 8 PATRICK H. MARTIN & BRUCE M. KRAMER, WILLIAMS & MEYERS OIL AND GAS LAW 476 (LexisNexis Matthew Bender 2013).

APPENDIX B

Formation. In geology, the primary formal unit of lithostratigraphic classification. A Formation is a rock unit which is distinctive enough in appearance so that a geologic mapper can tell it apart from the surrounding rock layers. It must also be thick enough and laterally extensive enough to plot on a map. Formations are given names that include the geographic name of a permanent feature near the location where the rocks are well exposed (outcrop). Formations can contain a variety of related or interlayered rock types or lithologies.

- Formations are the only formal lithostratigraphic units into which the stratigraphic column everywhere should be divided completely on the basis of lithology.
- The contrast in lithology between Formations required to justify their establishment varies with the complexity of the geology of a region and the detail needed for geologic mapping and to work out its geologic history.
- No Formation is considered justifiable and useful that cannot be delineated at the scale of geologic mapping practiced in the region. The thickness of Formations may range from less than a meter to several thousand meters.

South Texas' stacked oil and gas plays

The Eagle Ford Shale is nestled among various geologic layers, many of which also are producing oil and gas. Here's a look at how the various plays stack on top of each other.

Diagram is for illustrative purposes and is not complete or to scale, given the complexity of mapping geologic layers across different parts of the state. But it gives a general idea of the shallow and deeper layers across the state's coastal plains region.



Source: University of Texas Bureau of Economic Geology Research by Jennifer Hiller

Mike Fisher/San Antonio Express-News

Member. The formal lithostratigraphic unit next in rank below a Formation.

Formations can be divided into smaller units called Members. Members are useful where it is important to study or keep track of a particular subdivision of a Formation.

- A Member possesses lithologic properties distinguishing it from adjacent parts of the Formation.
- No fixed standard is required for the extent and thickness of a Member.
- A Formation need not be divided into members unless a useful purpose is thus served.
- Some formations may be completely divided into Members; others may have only certain parts designated as Members.
- A Member may extend from one Formation to another.
- Specially shaped forms of Members (or of Formations) are lenses and tongues.
- A lens is a lens-shaped body of rock of different lithology than the unit that encloses it.
- A tongue is a projecting part of a lithostratigraphic unit extending out beyond its main body.



en.wikipedia.org

Zone. A region or stratum distinguished by composition or content, a Horizon.

Horizon. Either a bedding surface where there is marked change in the lithology within a sequence of sedimentary rocks, or a distinctive layer or thin bed with a characteristic lithology or fossil content within a sequence.

Strata. Refers to stacked-up layers of sedimentary rock. Strata are distinguished from one another on the basis of their physical composition, in other words, the composition of sediment from which they are comprised. A sedimentary rock layer bounded by two stratification planes, the latter being produced by visible changes in the grain size, texture, or other diagnostic features of the rocks above and below the plane.



Facies. The characteristics of a rock or sediment unit that reflect its environment of deposition and allow it to be distinguished from rock or sediment deposited in an adjacent environment at the same time.

- Facies show a transgressive pattern when the sediment supply is overwhelmed by a relative rise in sea level, or when the land subsides tectonically.
- Facies show a regressive pattern when the shoreline move seaward due to an excess sediment supply from the land, when the land is tectonically uplifted and the sea retreats, or when there is a relative lowering of sea level.

Each depositional environment grades laterally into other environments, each change is referred to as a "facies change" when dealing with the rock record.



sajg.geoscienceworld.org

Depth. A dimension taken through an object or body of material, usually downward from an upper surface, horizontally inward from an outer surface, or from top to bottom of something regarded as one of several layers.

Elevation. Height above a given datum or level, usually sea level.

Topography. The art or practice of graphic delineation in detail usually on maps or charts of natural features of a place or region in a way to show their relative positions and elevations.



Fault. A planar fracture or discontinuity in a volume of rock across which there has been significant displacement along the fractures as a result of rock mass movement. Large faults within the Earth's crust result from the action of plate tectonic forces, with the largest forming the boundaries between the plates. Energy release associated with rapid movement on active faults is the cause of most earthquakes.



geotripperimages.com

Growth fault. Syndepositional or syn-sedimentary extensional faults that initiate and evolve he margins of continental plates. They extend parallel to passive margins that have high sediment supply. Their fault plane dips mostly toward the basin and has long-term continuous displacement. A growth fault possesses a concave upward fault plane that has high updip angle and flattened at its base into zone of detachment or décollement. This angle is continuously changing from nearly vertical in the updip area to nearly horizontal in the downdip area. Sedimentary layers grow thicker on the downthrown, basinward sides of growth fault planes.



geologyin.com

Thrust Fault. A type of fault across which there has been relative movement in which rocks of lower (usually older) stratigraphic position are pushed up and over higher (usually younger) strata. Thrust faults are the result of compressional forces.





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